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The European Defense Procurement Directive: An American Perspective

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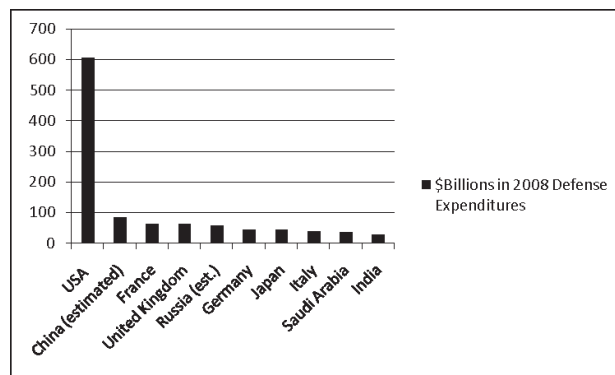
FEATURE COMMENT—The European Defense Procurement Directive: An American Perspective

Introduction—On August 21, the new European directive on defense and security procurement, Directive 2009/81/EC, entered into force. See, e.g., *EU Adopts New Defense and Security Procurement Directive*, 6 IGC ¶ 65. Previously, most European defense procurement was considered exempt from the European procurement directives that have harmonized procurement, with greater transparency and competition, across Europe. Under the new defense directive, all but the most sensitive defense and security procurements in Europe will have to be conducted under rules consistent with the new directive.

From an American vantage point, however, it is not yet clear how the new directive will be implemented. If the defense directive merely brings new competition and transparency to the European procurement markets, the directive will be a welcome improvement in what was traditionally a closed and uncompetitive market. But if, in practice, the directive is used as an excuse to discriminate against U.S. exporters—or if it is perceived as a tool of discrimination—the directive threatens to trigger serious trade frictions in the transatlantic defense markets.

The European Defense Market—When compared to the U.S. defense market, the European defense market is smaller and highly fragmented across the European member states—in part, as the European Commission itself has noted, because of the highly fragmented laws across the many na-

tions. See European Commission, *Interpretative Communication on the Application of Article 296 of the Treaty in the Field of Defense Procurement*, COM(2006)779, Introduction (“Defence procurement law is an important element of this fragmentation. The majority of defence contracts are exempted from Internal Market rules and awarded on the basis of national procurement rules, which have widely differing selection criteria, advertising procedures, etc. ... All of this can limit market access for non-national suppliers and therefore hampers intra-European competition.”); *Europe’s Movement Toward a More Competitive Market for Defense Procurement*, 1 IGC ¶ 46.



The fragmentation of the European defense market, and the stronger political emphasis put on defense spending in the U.S., mean that U.S. defense expenditures tend to loom large when compared to the individual European nations’ defense spending. The Stockholm International Peace Research Institute estimates that U.S. defense spending in 2008 totaled over \$600 billion, substantially overshadowing any other single nation’s defense spending. See chart above, “\$Billions in 2008 Defense Expenditures,” with data from *SIPRI 2009 Yearbook*, at 11, www.sipri.org/yearbook/2009/files/SIPRIYB09summary.pdf.

The European Commission estimated in 2004 that overall defense expenditures in the EU member states totaled approximately €160 billion (roughly \$235 billion at current exchange rates).

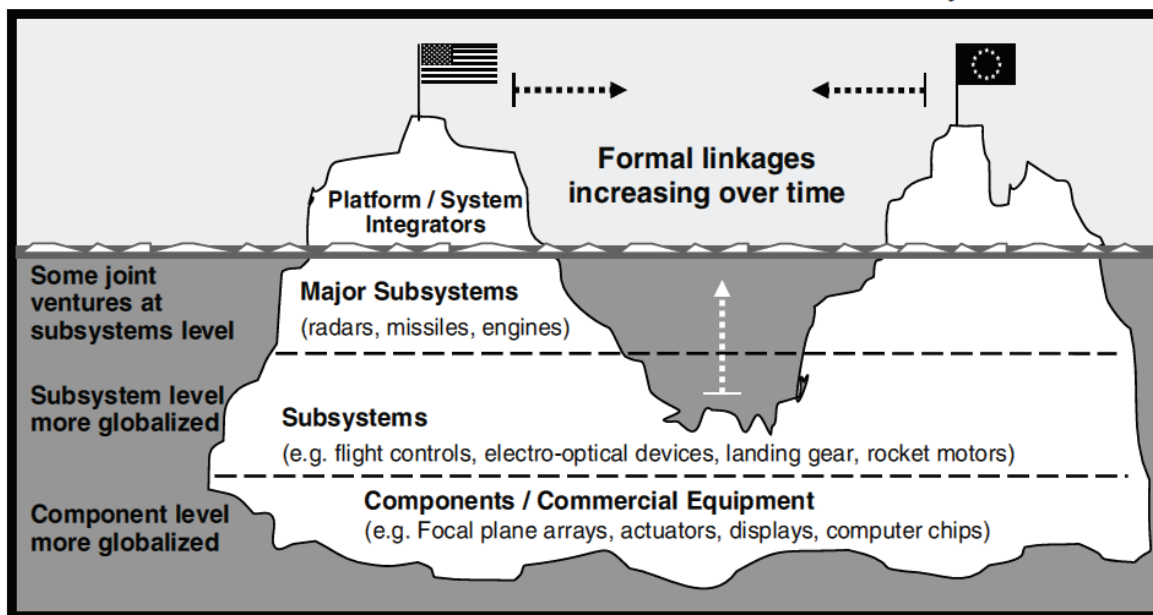
See European Commission, COM(2004)608, *Green Paper on Defence Procurement*, at 3 (2005), available at ec.europa.eu/internal_market/publicprocurement/dpp_en.htm; Aris Georgopoulos, *The Commission's Green Paper on Defence Procurement*, 2005 Pub. Proc. L. Rev. NA34. The overall European defense procurement market has been estimated at more than €80 billion (over approximately \$117 billion) annually; of that, the European Commission estimated in 2006, roughly €30 billion (\$45 billion) went to new equipment. European Commission Press Release IP/06/1703 (Dec. 7, 2006).

The barriers between the European member states' defense markets historically have been high, due to national preferences and cumbersome licensing requirements for transferring sensitive technologies across borders. See, e.g., David R. Scruggs, Guy Ben-Ari, Michele Flournoy and Julianne Smith, Center for Strategic and International Studies (CSIS), *European Defense Integration: Bridging the Gap Between Strategy and Capabilities*, at 74-75 (October 2005), available at csis.org/publication/european-defense-integration-bridging-gap-between-strategy-and-capabilities; Joachim Hofbauer, *Implications of European Defense Acquisition Reform*, Center for Strategic and International Studies, Current Issues No. 15 (Oct. 19, 2009); Martin Trybus, *European Defence Procurement Law* (1999).

The EU has been working for some time to improve Europe's military capabilities, see David R. Scruggs et al., *supra*, at 54-60, and the trend in European defense procurement has been towards greater openness and competition, see Jeffrey P. Bialos, Christine E. Fisher and Stuart L. Koehl, *Fortresses and Icebergs: The Evolution of the Transatlantic Defense Market and the Implications for U.S. National Security Policy*, at 12-13 (Johns Hopkins University, School of Advanced International Studies, Center for Transatlantic Relations) (executive summary available at csis.org/event/book-launch-fortresses-and-icebergs-jeffrey-p-bialos). European policymakers hope the new procurement directive, and an earlier directive to facilitate intra-European transfers of sensitive technologies, see European Commission, *EU Transfers of Defence-Related Products*, ec.europa.eu/enterprise/regulation/inst_sp/defense_en.htm (discussing Directive 2009/43/EC), will help bring together the member states' defense markets, to support development of the European defense-related supplier base. See, e.g., *EDA Continues Push for Integrated EU Defense Industry*, 4 IGC ¶ 37.

The U.S. has a direct interest in stronger European defense capabilities, as the U.S. will likely work closely with its European allies to combat future shared threats. See, e.g., Klaus Naumann and Gen. Joseph Ralston (ret.), Foreword, in David R. Scruggs

The Transatlantic Defense Industry



Source: U.S. Department of Defense, Office of Deputy Under Secretary of Defense for Industrial Policy.

et al., *supra*, at 4. An important recent report, Jeffrey P. Bialos et al., *Fortresses and Icebergs*, *supra*, discussed the current integration between the U.S. and European defense industries. The authors of this very comprehensive report drew on a metaphor commonly used to describe the two markets' improving integration, the "iceberg," to describe relative isolation at the platform/systems integrator level, and much more extensive integration at lower levels of the supply chain. See figure on previous page, "The Transatlantic Defense Industry," from Jeffrey P. Bialos et al., *Fortresses and Icebergs*, *supra*, at 7.

Despite this growing integration in the transatlantic defense market, the authors of *Fortresses and Icebergs* concluded that, over the coming years, new efficiencies within the market and growing external barriers to the European defense market—including, potentially, efficiencies and barriers caused by the defense procurement directive itself—are likely to reduce U.S. exporters' share of that market. *Id.* at 12–18; see also Stacy N. Ferraro, *The European Defense Agency: Facilitating Defense Reform or Forming Fortress Europe?*, 16 *Transnat'l & Contemp. Probs.* 549, 620 (2007) ("U.S. defense firms should expect increased difficulties competing in Europe with each passing year of the [European Defence Agency's] existence, which is due to Europe's creating the legal and administrative framework that will facilitate the ease of transfer and development of defense equipment within Europe").

The European Procurement Directives—

To understand the European defense procurement directive, it is important to understand that the defense directive is only the latest in a long series of European procurement directives, stretching back several decades. See, e.g., Susan R. Sandler, *Cross-Border Competition in the European Union: Public Procurement and the European Defence Equipment Market*, 7 *Wash U. Global Stud. L. Rev.* 373 (2008). These directives set frameworks—a minimum set of requirements—within which member states may write their procurement laws and rules. If a European member state's procurement procedures or practices violate the directives, interested parties (including, potentially, a disappointed bidder) may seek relief, potentially (depending on the circumstances) through the Commission, the courts, or other bid protest (or "remedies") mechanisms.

The directives have grown increasingly detailed and prescriptive over the years, as the European

Commission has pushed to exert more control over the sometimes fractious European procurement market. See generally Sue Arrowsmith, *The Past and Future Evolution of EC Procurement Law: From Framework to Common Code?*, 35 *Pub. Cont. L.J.* 337 (2006); Jean-Jacques Verdeaux, *Public Procurement in the European Union and in the United States: A Comparative Study*, 32 *Pub. Cont. L.J.* 713 (2003); Charlene Barshefsky, Alastair Sutton and Jo Anne Swindler, *Developments in EC Procurement Law Under the 1992 Program*, 1990 *Brig. Young U. L. Rev.* 1269; Allen B. Green, *European Community Procurement—Part II*, 91-6 Briefing Papers 1. The directives' core goal is simple: to unify procurement markets across the European continent, by harmonizing procurement rules and processes.

The Defense Directive—The latest directive extends the goal of European integration to defense markets by establishing a common framework for defense procurements across the member states. See, e.g., Wolfram Hertel, Falk Schning and David W. Burgett, *Feature Comment: New EU Legal Framework for the Defense Industry*, 50 *GC ¶ 399*; see also Baudouin Heuninckx, *A Primer to Collaborative Defence Procurement in Europe: Troubles, Achievements and Prospects*, 2008 *Pub. Proc. L. Rev.* 123 (discussing option of collaborative procurement). The new directive is intended to counter what was an "historically nationalistic approach to defense procurement," which cut "against the core princip[les] of the European Community, which has as its central premise—inherent in its treaty obligations—the concept of a 'single market.'" Jeffrey P. Bialos et al., *Fortresses and Icebergs*, *supra*, at 181; see also Aris Georgopoulos, *Comment on the Recent Developments in European Defence Procurement Integration Initiatives*, 2008 *Pub. Pro. L. Rev.* NA8.

The new directive squarely addresses two of the leading objections to general European requirements for defense procurement. See, e.g., Tim Briggs, *The New Defence Procurement Directive*, 2009 *Pub. Proc. L. Rev.* NA129. First, the new directive includes special provisions, not part of the general procurement directives (Directives 2004/17/EC and 2004/18/EC), to accommodate classified information and security of supply. Second, the new directive exempts member states' procurements if they "are so sensitive that even the new rules cannot satisfy their security needs." Commission Press Release IP/09/1250 (Aug. 25, 2009).

This latter point—which sensitive procurements should be exempt from European regulation and left to the sovereign discretion of the member states—had long been contentious. See, e.g., Aris Georgopoulos, *The European Commission Proposal for the Enactment of a Defence Procurement Directive*, 2008 Pub. Proc. L. Rev. 81; Baudouin Heuninckx, *Towards a Coherent European Defence Procurement Regime? European Defence Agency and European Commission Initiatives*, 2008 Pub. Proc. L. Rev. 1. Article 296 of the Treaty Establishing the European Community protects member states' sovereignty, and allows any member state to "take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material." See Sue Arrowsmith, *supra*, 35 Pub. Cont. L. J. at 367–68.

While the European Court of Justice's decisions had interpreted Article 296 narrowly, as the European Commission acknowledged in a 2004 position paper, "in the absence of a precise interpretation of these provisions, there is quasisystematic use of the derogation in the area of public procurement." European Commission, *Green Paper on Defence Procurement*, *supra*, at 6. The Commission noted that, despite the ECJ's clarifications of Article 296, "the low number of [defense procurement] publications in the Official Journal of the European Union [the official gazette for publicizing European procurement opportunities] appear[ed] to imply that some Member States believe[d] they [could] apply the derogation automatically." *Id.* Thus, despite a cautionary Commission *Interpretative Communication on the Application of Article 296*, *supra*; see also Aris Georgopoulos, *The Commission's Interpretative Communication on the Application of Article 296 EC in the Field of Defence Procurement*, 2007 Pub. Proc. L. Rev. NA43; *EU Continues Efforts to Build Up Defense Industry*, 4 IGC ¶ 10, apparently many member states have been routinely ignoring the existing procurement directives when they carry out defense procurements.

As a form of secondary procurement legislation, the defense directive is an important step forward, though it is certainly not a radical step forward:

- Directive Allows Flexible Procurement Methods: Recognizing the complexity of most defense procurements, the new directive takes a more flexible approach to permitted procurement methods. The directive would permit, *inter alia*,

publicized "negotiated" procurements (what we in the U.S. would call less than full-and-open competition, or, in extreme cases, "sole-source" procurements), and competitive dialogue (the analogue to contracting by competitive negotiation under Federal Acquisition Regulation pt. 15 in the U.S. federal system). See Directive 2009/81/EC, Chapter V. From a U.S. perspective, what is surprising is the defense directive's drafters' slight reluctance to allow the use of competitive dialogue, see *id.* Article 37 (report required explaining use of competitive dialogue). In U.S. defense procurement, the parallel procedures (competitive negotiations under FAR pt. 15) are, in contrast, the norm in advanced weapon systems procurements.

- Directive Allows Framework (IDIQ) Contracts: The new directive also specifically allows "framework" agreements, which are known in the U.S. federal system as indefinite-delivery, indefinite-quantity contracts. On both sides of the Atlantic, these are increasingly popular vehicles for contracting. See Christopher R. Yukins, *Are IDIQs Inefficient? Sharing Lessons with European Framework Contracting*, 37 Pub. Cont. L.J. 545 (2008).
- Socioeconomic Programs Eased from Defense Procurements: In many nations, European defense procurement has long been burdened with socioeconomic goals. "Many European defense procurement programs today," noted a 2005 CSIS report, "are indirect jobs programs; parliaments across Europe embed the retention of jobs into their defense procurement budgets as a central goal even when these policies result in higher costs than buying equipment from alternative sources." David R. Scruggs et al., *European Defense Integration*, *supra*, at 72. The defense directive attempts to ease socioeconomic goals—specifically, jobs creation—from the European defense realm, by insisting that "no performance conditions may pertain to requirements other than those relating to the performance of the contract itself." Recital (45); see Article 20. This bar is apparently intended, at least in part, to exclude extraneous conditions—including socioeconomic requirements that are not directly related to contract performance.
- Bid Protests/Remedies: In keeping with the European nations' increasing reliance on bid

protest (“remedies”) systems, see, e.g., Martin Dischendorfer and Sue Arrowsmith, Case Comment: *Case C-212/02, Commission v. Austria: The Requirement for Effective Remedies to Challenge an Award Decision*, 2004 Pub. Proc. L. Rev. NA165, Title IV of the new defense directive includes extensive provisions for challenges to awards under the new directive. There are no parallel provisions for protests under the U.S.’ reciprocal defense agreements with European nations (discussed below), and so one logical question would be whether these remedies provisions should be incorporated by reference into those bilateral agreements, to ensure that U.S. exporters have recourse to review to challenge discrimination they may experience in the European defense market.

Potential Discriminatory Impact—European policymakers have been careful to emphasize that the new directive is not, on its face, discriminatory against U.S. and other foreign exporters to the European defense market. A “Frequently Asked Question” posted with the new directive noted:

Directive 2009/81/EC will not change the situation for arms trade with third countries, which remain governed by [World Trade Organization] rules and in particular the Government Procurement Agreement (GPA). It remains Member States’ decision to open or not to open competition to non-EU suppliers, in compliance with the GPA. Awarding authorities will still be free to invite EU companies exclusively, or to include non-EU companies.

ec.europa.eu/internal_market/publicprocurement/docs/defence/faqs_28-08-09_en.pdf. By its terms, the directive also will not cover procurements done under cooperative arrangements (such as European nations’ joint defense initiatives with NATO), see Recital (28), and procurements governed by member states’ separate agreements with other nations (such as the U.S. reciprocal defense agreements, discussed below), *id.* Recital (26). See Directive 2009/81/EC, Recitals (26), (28), Articles 12 (contracts awarded pursuant to international rules) & 13 (specific exclusions). These exclusions will likely provide U.S. vendors with important safe harbors against discrimination.

Nevertheless, there remains serious concern that in practice the new directive could be used to discriminate against U.S. (and other foreign) vendors. For U.S. exporters, this is an especially acute concern because

for many years U.S. defense exports to Europe have consistently exceeded (by wide margins) European defense exports to the U.S.—an “imbalance” of which Europeans have been keenly aware, and which has itself stirred trade frictions. See, e.g., Jeffrey Bialos et al., *Fortresses and Icebergs*, *supra*, at 122–23; Aris Georgopoulos, *U.S. Air Force Tanker Contract: Revisiting American Protectionism in Defence Procurement?*, 2008 Pub. Proc. L. Rev. NA162. To maintain their share of the European market, U.S. exporters will likely remain highly sensitive to the potentially discriminatory impacts of the new directive:

- **Directive Hints at Power to Exclude:** Because, as noted, the WTO GPA generally does not cover defense materiel, the directive leaves open the possibility that European member states may exclude foreign vendors in the defense market. The general exclusion of defense materiel from the GPA, notes Recital (18) of the directive, “means also that in the specific context of defence and security markets, Member States retain the power to decide whether or not their contracting authority/entity may allow economic operators from third countries to participate in contract award procedures.” Although the directive suggests that member states “should take that decision on grounds of value for money,” and recognizes the need for “open and fair markets,” the directive also recognizes “the need for a globally competitive European Defence Technological and Industrial Base,” and the importance of “obtaining of mutual benefits”—all of which may be read, by some, to countenance discrimination against foreign defense contractors.
- **Special Security Requirements May Exclude U.S. Firms:** The new defense directive specifically allows for requiring special security measures in procurement, and for requiring security of supply. E.g., Directive 2009/81/EC, Recital (42), Articles 7 (protection of classified information), 22 (security of information), 23 (security of supply). The recitals further call for a “[European] Union-wide regime on security of information, including the mutual recognition of national security clearances and allowing the exchange of classified information between contracting authorities/entities and European companies,” and specifically acknowledge that, for now, member states have extensive discretion in setting secu-

city requirements. *Id.* Recitals (9), (68). As this internal European security regime continues to take shape, U.S. firms may find that this raises, in practice, a barrier to entry to the European defense market.

- **Technical Specifications May, In Practice, Discriminate:** Unlike the WTO GPA, which specifically calls for nondiscriminatory technical specifications, the new defense directive gives a preference to technical specifications based on “international,” “European” or “national” standards. See Directive 2009/81/EC, Recital (38), Article 18 (technical specifications). In practice, this may discriminate against U.S. products built around non-European, and non-international, standards.
- **Specially Sensitive Procurements Excluded:** By its terms, per Recital (27) and Article 13, the directive excludes specially sensitive procurements, including “procurements provided by intelligence services, or procurement for all types of intelligence activities ... as defined by Member States,” and “particularly sensitive purchases which require an extremely high level of confidentiality, such as ... certain purchases intended for border protection or combating terrorism.” Because of the subjective and broad nature of these exemptions, they may be overused, in practice, to shield procurements from the transparency and competition that the new directive would normally require.
- **Article 296 Loophole Still Available:** Although the intent behind the new defense directive was to narrow the instances when member states can claim exemption from general procurement rules on grounds of national security, per Article 296, Recital (16) of the new directive itself leaves the door open for asserting an exemption under Article 296 where, for example, “contracts in the fields of both defence and security ... necessitate such extremely demanding security of supply requirements or which are so confidential and/or important for national sovereignty that even the specific provisions of this Directive are not sufficient to safeguard Member States’ essential security interests.” By leaving this door open to defense procurements outside the directive, the Commission has left open the possibility that member states—which

retain “sole responsibility” for their national security, *id.* Recital (1)—may attempt to exclude foreign competition by asserting exemptions under Article 296.

- **Limited Protections Under WTO GPA:** The GPA, which European policymakers often point to as the main guarantor of open markets, generally does not cover trade in arms, munitions and defense materials. See GPA, Art. XXIII(1) (“Nothing in this Agreement shall be construed to prevent any Party from taking any action or not disclosing any information which it considers necessary for the protection of its essential security interests relating to the procurement of arms, ammunition or war materials, or to procurement indispensable for national security or for national defence purposes.”). Specific nations’ coverage under the GPA also tends to exclude defense items; for example, the European Communities’ Annex 1 to the WTO GPA, which lists the European agencies and products open to competition from other GPA members, covers only part of the defense market. *Id.*, available at www.wto.org/english/tratop_e/gproc_e/appendices_e.htm. Many European procuring entities and procurements are simply not covered by the GPA, which has always focused primarily on non-defense procurement.
- **Reciprocal Defense Agreements Do Not Provide Complete Protection Against Discrimination:** For decades, the U.S. and many of the European Community’s member nations have agreed, through bilateral memoranda of understanding (reciprocal defense agreements), to open their respective defense procurement markets. See Drew B. Miller, Note, *Is It Time to Reform Reciprocal Defense Procurement Agreements?*, 39 Pub. Cont. L.J. 93 (2009) (forthcoming); U.S. Government Accountability Office, *Federal Procurement: International Agreements Result in Waivers of Some U.S. Domestic Source Restrictions* (GAO-05-188), at 23 (2005) (listing countries), www.gao.gov/new.items/d05188.pdf; *International Agreements Waive U.S. Domestic Source Restrictions*, 47 GC ¶ 89. These bilateral agreements are implemented in U.S. law through § 225.872 of the Defense FAR Supplement, and are gathered at www.acq.osd.mil/dpap/cpic/ic/reciprocal_procurement_memoranda_of_understanding.html. Under these agreements,

the U.S. has generally agreed not to discriminate against defense supplies from partner “qualifying nations.” These agreements, which cover many, but not all, of the European member states, do not provide complete protection against discrimination in the transatlantic defense trade. See Drew B. Miller, *supra*. For example, as noted, unlike the GPA, these agreements typically do not include a provision allowing suppliers to protest (sue for remedies) under national law to enforce their rights against discrimination; instead, the agreements generally leave it to the signatory defense ministries to resolve any disagreements through consultation. See, e.g., *Memorandum of Understanding Between the Federal Minister of Defense of the Federal Republic of Germany and the Secretary of Defense of the United States of America Concerning the Principles Governing Mutual Cooperation in the Research and Development, Production, Procurement and Logistic Support of Defense Equipment*, Art. VII (1978), www.acq.osd.mil/dpap/Docs/mou-germany.pdf. If U.S. vendors fear discrimination under the new directive, they may press for broader remedies under these bilateral agreements.

Conclusion—The challenge for the U.S. procurement community is to see the new defense directive

as part of a changing, dynamic transatlantic defense market, and to understand how the directive relates to the U.S.’ broader national security interests. If the directive, as intended, strengthens the European defense supplier base and enhances competition and transparency in European defense procurement, the directive will advance the U.S.’ interests in a robust transatlantic defense market. If, however, the directive is implemented by member states to lock out U.S. or other foreign exporters—or if it is perceived as a protectionist tool—the directive may, unfortunately, serve as a flashpoint for protectionism.



This FEATURE COMMENT was written for THE GOVERNMENT CONTRACTOR by Christopher R. Yukins (cyukins@law.gwu.edu), Associate Professor of Government Contract Law and Co-Director of the Government Procurement Law Program at The George Washington University Law School.

Author’s Note: On Friday, November 6, at The George Washington University Law School, 2000 H Street N.W., Washington, D.C., from 9:30–11:00 a.m., a colloquium will be held on the new European defense procurement directive. For further information on the colloquium, please visit www.pubklaw.com/events/gwu110609.pdf.